

Message Text

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ACTION EUR-12

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C O N F I D E N T I A L OTTAWA 0533

STATE FOR COOPER AND HARTMAN; TREASURY FOR SOLOMON AND
BERGSTEN; CEA FOR SCHULTZE

E.O. 11652: GDS
TAGS: EGEN, CA
SUBJ: CANADIAN ECONOMY NEEDS STIMULUS

1. THERE IS A STRONG CASE NOW FOR ENCOURAGING CANADA TO
JOIN THE BANK OF COUNTRIES RESTIMULATING THEIR ECONOMIES.

2. TWO IMMEDIATELY FOLLOWING CABLES (OTTAWA 0531 AND
0532) GIVE CURRENT JUDGMENTS ON THE CANADIAN ECONOMY
AND BALANCE OF PAYMENTS. ABSENT SIGNIFICANT STIMULUS, THE
OUTLOOK IS FOR SLUGGISH GROWTH (IN THE THREE TO FOUR PERCENT
RANGE) INCREASING UNEMPLOYMENT (TOWARD EIGHT PERCENT),
MIDDLING PRICE PERFORMANCE (CPI IN SIX TO SEVEN PERCENT
RANGE), A RISING TRADE SURPLUS BUT A SUBSTANTIAL ONGOING
CURRENT ACCOUNT DEFICIT, CONTINUED HEAVY LONG-TERM
BORROWING STIMULATED IN PART BY TIGHT MONEY, AND A
RELATIVELY FIRM EXCHANGE RATE.

3. THE CANADIAN GOVERNMENT IS EDGING TOWARDS STIMULUS,
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TALKING ABOUT REMOVING WAGE AND PRICE CONTROLS THIS YEAR,
EASING UP A LITTLE ON MONETARY POLICY, AND FORECASTING
SOME BUDGET ACTION IN THE APRIL TO JUNE TIMEFRAME. BUT
IT HAS STILL NOT MADE UP ITS MIND TO MOVE EITHER FAR OR
FAST.

4. WHY DOESN'T OTTAWA STIMULATE THE ECONOMY IN ITS OWN

INTEREST? THE REASON IS THE LARGE CAPITAL THE CANADIAN GOVERNMENT AND TRUDEAU PERSONALLY HAVE INVESTED IN THEIR ANTI-INFLATION PROGRAM. TRUDEAU TELLS ME HE IS DETERMINED TO KNOCK INFLATION ONCE AND FOR ALL. HAVING ALREADY TAKEN A BATH IN THE POLLS AFTER IMPOSING WAGE AND PRICE CONTROLS IN NOVEMBER 1975, HE SAYS IT DOESN'T COST HIM MUCH POLITICALLY TO CONTINUE RESTRAINT NOW SO LONG AS THE ECONOMY IS DOING OK AT ELECTION TIME, EXPECTED FOR MID-1978. OTHER CANADIANS FEAR THAT STIMULUS NOW COULD ENCOURAGE LABOR TO TAKE ADVANTAGE OF THE END OF CONTROLS THIS YEAR TO GO FOR MAJOR CATCH-UP WAGE INCREASES, AND THUS MAKE CANADA EVEN LESS COMPETITIVE ON INTERNATIONAL MARKETS. IN A NUMBER OF KEY INDUSTRIES THE CANADIAN WAGE LEVELS ARE ALREADY SIGNIFICANTLY HIGHER THAN AMERICAN, WHILE PRODUCTIVITY IS LOWER.

5. WHETHER RENEWED STIMULUS WOULD INCREASE PRICES AND WAGES AT ALL SIGNIFICANTLY IS CONTROVERSIAL HERE. WITH EXCESS CAPACITY AND HIGH UNEMPLOYMENT, THE MODELS OF COURSE DO NOT SHOW ANY SIGNIFICANT ADDITIONAL PRICE PRESSURES DEVELOPING. AND THE GOVERNMENT WILL NEED (AND IS ALREADY WORKING FOR) SOME FORM OF CONSENSUS WITH LABOR ON WAGE BEHAVIOR AFTER CONTROLS COME OFF, WHETHER OR NOT STIMULUS IS APPLIED.

6. ALTHOUGH THERE IS SOME CONCERN IN OTTAWA ABOUT THE LONG-TERM IMPLICATIONS OF CONTINUED HEAVY CURRENT ACCOUNT DEFICITS, THAT SHOULD NOT BE AN OBSTACLE TO STIMULUS THIS SPRING. LONG-TERM FINANCING APPEARS SUFFICIENT AND SOME EXCHANGE RATE ADJUSTMENT MAY ALSO OCCUR.
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7. WHAT IS THE U.S. INTEREST? THE DIRECT EFFECTS OF INCREASED GROWTH IN THE CANADIAN ECONOMY ON THE UNITED STATES ARE EQUIVALENT TO THOSE OF THE FOUR MAJOR EUROPEAN ECONOMIES COMBINED, ALTHOUGH CHANGES IN THE ALTER STILL COUNT FOR MORE IF YOU INCLUDE THIRD COUNTRY EFFECTS. GIVEN ITS IMPORTANCE IN WORLD TRADE, A LAGGING CANADA WOULD BE A SIGNIFICANT OMISSION FROM EFFORTS TO GET THE WORLD'S ECONOMY AS A WHOLE MOVING TOWARDS A HIGHER GROWTH TRACK.

8. WHAT IS NEEDED NOW IS NOT U.S. PRESSURE, BUT U.S. ENCOURAGEMENT. ALTHOUGH THE CANADIAN ECONOMY IS LESS IN SYNCH WITH THE U.S. THAN IN THE PAST, U.S. POLICY AND ATTITUDES REMAIN HIGHLY INFLUENTIAL HERE. WHEN TRUDEAU IS IN WASHINGTON FEBRUARY 21-23, AND WHEN INDUSTRY, TRADE AND COMMERCE MINISTER CHRETIEN AND FINANCE MINISTER MACDONALD FOLLOW HIM A WEEK OR TWO LATER, WE SHOULD EXPRESS INTEREST IN THE LOW PROJECTED LEVEL OF GROWTH

THIS YEAR, AND ASK ABOUT WHETHER AND WHEN SIMULUS IS PLANNED
AND HOW MUCH. THE POINT SHOULD BE MADE THAT IF CANADA
WANTS TO BE ACCEPTED AS A PERMANENT MEMBER OF THE
BIG SEVEN, IT WILL HAVE TO ACCEPT ALSO THAT OTHERS
EXPRESS INTEREST IN AND VIEWS ON ITS ECONOMIC
PERFORMANCE.
ENDERS

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